

Perpetual Investments

PERPETUAL ETHICAL SRI CREDIT FUND

June 2022



FUND FACTS

Investment objective: To provide investors with regular income and consistency of return by investing in a diversified range of income generating, ethical and socially responsible assets. To outperform the stated benchmark over rolling three year periods before fees and taxes.

Benchmark: Bloomberg AusBond Bank Bill Index
Inception date: June 2018
Size of fund: \$55.9 million as at 30 June 2022
APIR: PER1744AU
Mgmt cost: 0.59%pa*
Benchmark Yield: 0.39% as at 30 June 2022
Suggested minimum investment period: Three years or longer

FUND BENEFITS

Provides investors access to an actively managed fund that more closely matches their personal social and ethical beliefs or preferences, without compromising investment returns over the long term.

FUND RISKS

All investments carry risk and different strategies may carry different levels of risk. The relevant product disclosure statement or offer document for a fund should be considered before deciding whether to acquire or hold units in that fund. Your financial adviser can assist you in determining whether a fund is suited to your financial needs.

TOTAL RETURNS % (AFTER FEES) AS AT 30 June 2022

	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS PA	3 YRS PA	5 YRS PA	7 YRS PA	INCEPT PA
Perpetual Ethical SRI Credit Fund	-1.11	-1.63	-2.49	-2.12	1.73	1.25	-	-	1.67
Bloomberg AusBond Bank Bill Index	0.05	0.07	0.08	0.10	0.08	0.33	-	-	0.76

Please note: Performance for Perpetual's complete list of investment funds is available on www.perpetual.com.au. Past performance is not indicative of future performance.

POINTS OF INTEREST

- Financial markets weaken on inflation and recession concerns;
- AUD spreads widen: EUR spreads underperform dramatically;
- Yields rise early before rallying; RBA increases 50bps;
- Corporate primary issuance subdued; securitisation robust;
- The outlook for credit has improved while remaining negative.

ETHICAL EXCLUSIONS AND SRI SCREENING

There are two main steps to the process, namely ethical exclusions and socially responsible investments (SRI) screening.

ETHICAL EXCLUSIONS

We don't invest in issuers or counterparties that derive a material proportion (5% or more) of their revenue from:

- the manufacture or sale of alcohol or tobacco[^]
- the operation of gambling facilities or the manufacture of gambling equipment
- fossil fuels (upstream)
- uranium and nuclear
- animal cruelty (cosmetic testing)
- genetic engineering
- pornography
- armaments (including weapons)[^]

[^]For involvement in the production of tobacco, tobacco based products and the development and production of controversial weapons, a 0% revenue threshold is applied.

SRI SCREENING

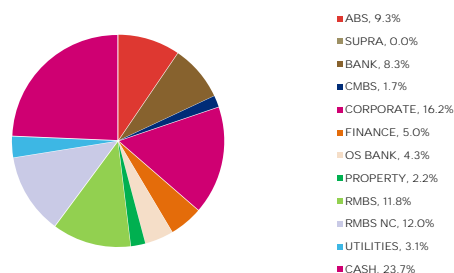
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment. While other companies become allowable investments.

SOVEREIGN ISSUERS

Governments will be analysed on ESG factors, based on a scoring system utilising research from external specialists. This may include, but is not limited to, considering any unethical practices such as corruption, rule of law and political instability of the sovereign.

For further details on the Ethical Exclusions or SRI screening please refer to the PDS.

PORTFOLIO SECTORS



PORTFOLIO COMPOSITION

	BREAKDOWN
Senior Debt	53.87%
Subordinated Debt	38.12%
Hybrid Debt	8.01%
Running Yield [^]	2.59%
Portfolio Weighted Average Life	2.73 yrs
No. Securities	95
Modified Duration	0.45

* Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS.

[^]The methodology used to calculate Running Yield is derived from FactSet, and calculated as follows: The coupon rate of the security / the capital price of the security. Note that the exception is discounted securities, where a Yield to Maturity calculation is used.

MARKET COMMENTARY

Financial markets were again in turmoil during June. Rising inflation weighed on equity and fixed income markets over the first two weeks of the month. Recession risks took prominence over the second half of June with bond yields rallying while credit and equities continued to weaken.

Leading economic indicators deteriorated throughout June as high inflation and rising interest rates were reflected in falling business and consumer sentiment. Purchasing manager indices continued to fall over the quarter with the latest ISM US manufacturing survey reading the lowest in two years.

Domestic bond yields sold off sharply over the first two weeks of June before rallying to end the month. Yields rose along the curve in reaction to accelerated monetary policy tightening, with 10-year yield rising above 4% during mid-June. High US inflation and the Fed's 75bps hike precipitated the global selloff in bonds. The RBA elected to increase the target cash rate by 50bps, which was higher than market expectations. As recession risks were foregrounded, yields rallied sharply but ended higher for the month.

Domestic credit spreads moved wider over the month. Australian dollar spreads were more resilient than offshore peers, supported by reduced primary market issuance. EUR spreads, in particular, widened dramatically following hawkish rhetoric from the ECB and increasing economic growth concerns.

Primary market issuance was subdued during June. The major banks were absent, following a flurry of issuance in May. Lloyds Banking Group issued in AUD for the first time in three years, pricing \$500M of 5-year fixed rate notes. In the non-financial corporate space, Ampol raised \$150M in subordinate sustainability-linked debt. Securitised sectors saw more action with year-to-date aggregate issuance remaining above trend. NAB issued a \$1.5B RMBS deal – its first since 2018. The deal included a \$500M AAA green tranche.

PORTFOLIO COMMENTARY

Credit spread widening was the most significant factor, contributing to underperformance over the month. Credit spreads continue to widen over the month. While domestic credit was supported by reduced issuance volumes, EUR spreads widened drastically on the back of a hawkish shift from the ECB and rising economic growth concerns. The fund holds a small selection of EUR denominated hybrid securities across offshore banks and the telecommunications sectors. These positions detracted from performance during the month as credit spread widening on many EUR denominated bonds was indiscriminate, even impacting bonds issued by companies domiciled and operating outside of Europe.

Towards the end of the month, the Manager added a long position in the EURO crossover CDS index (which tracks European non-investment grade corporate issuers) following the significant widening of credit spreads on European credit indices.

The impact of widening credit spreads was mitigated by the contribution of income return to relative performance over the month. Contributions to income return were broad based, led by RMBS, non-financial corporate, domestic and offshore banks. The portfolio's running yield was 2.6% at month end with the spread measured at 2.0%.

The Fund continues to hold and actively trade Australian government bonds, adding to portfolio liquidity, and reducing credit risk while contributing to running income. Secondary credit market conditions remain somewhat disrupted and the high liquidity and low transaction costs (bid/offer spreads) of government bonds relative to credit securities continues to be valuable. Yields rose sharply over the first two weeks of June, ending the month higher despite a late month rally. As a result, the fund's small duration exposure detracted from performance.

Sector allocation was actively managed. During the month, the Fund's exposure to RMBS was trimmed. With a challenging outlook for credit spreads and reduced liquidity in secondary markets, risk management remains paramount. The Fund maintains its defensive positioning while retaining the flexibility to take advantage of relative value opportunities presented by recent volatility.

The fund applies both ethical and socially responsible investment (SRI) screens relating to what the company is in the business of and the way business operations are conducted respectively. Upon application of the ethical and SRI screens, several bond issuers have been screened out. These include, for example, companies involved in the extraction of fossil fuels or companies whose revenues are significantly associated with socially questionable products or services.

OUTLOOK

The credit outlook has improved slightly while remaining challenged.

Valuation indicators improved over the month while remaining slightly negative. Rising swap spreads were constructive for the outlook. The domestic credit market remains expensive relative to offshore markets across relative spread and basis swap indicators.

The growth outlook is unchanged, remaining neutral. PMIs remain constructive but continue to weaken and global recession concerns rose over the month. Equity capital markets remain tight, detracting from the outlook. The most significant positive contributor remains the ratio of credit upgrades to downgrades, although US high yield is showing signs of slowing.

Recent supply has improved. Primary market volumes slowed slightly over June as financial conditions tightened. Demand remains slightly negative. Investors are selective with the success of primary deals increasingly name dependent. The upcoming maturity schedule is slightly elevated and expected to be constructive for spreads.

Technical indicators have improved while remaining slightly negative. Secondary market liquidity remains somewhat disrupted with smaller bid sizes and an elevated premium for holding risk. US credit, equity and equity volatility indicators remain negative.

With a challenging outlook for spreads, risk management remains paramount. The team continues to position to defend capital while evaluating opportunities presented by the current market conditions.

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